THE HON'BLE SRI JUSTICE V.V.S.RAO

COMPANY APPEAL No.11 OF 2004

DATED 06.08.2009

BETWEEN:

G.Haranadh

…Appellant

AND

Sri Lakshmi Durga Products (India) Limited and others

… Respondents

THE HON'BLE SRI JUSTICE V.V.S.RAO

COMPANY APPEAL No.11 of 2004

JUDGMENT:

This appeal under Section 10F of the Companies Act, 1956 is against the order dated 03.12.2004 passed by Company Law Board, Chennai (CLB) in C.P.No.58 of 2002 under Sections 397 and 398 read with Sections 235 and 237 of the Companies Act. While declining the reliefs prayed in the company petition, learned CLB disposed of the company petition directing first respondent company to issue notice of meetings to petitioner and further giving liberty to petitioner to take steps for winding up first respondent company as it was closed in 1998. Appellant (hereafter referred to as, Petitioner) is therefore before this Court.

In his company petition before learned CLB, petitioner alleged that first respondent company which was incorporated as Public Limited Company with object of manufacturing and marketing all kinds of paper and paper products was promoted by second respondent. The authorized capital of Rs.45,00,000/- (Rupees forty five lakhs only) consisting of 4,50,000 equity shares of Rs.10/- each was subsequently increased to Rs.75,00,000/- (Rupees seventy five lakhs only), challenging which, company petition was filed. Petitioner and his family members invested money in the company and they had 47,500 equity shares. In 1998, second respondent filed Form No.23 before Registrar of Companies (RoC) showing as if Extra Ordinary General Meeting (EGM) had been convened on 23.03.1998 for increasing authorized capital from Rs.45,00,000/- (Rupees forty five lakhs only) to Rs.75,00,000/- (Rupees seventy five lakhs only). Petitioner alleges that there was no EGM, and therefore, increase of authorized share capital is void *ab initio*. Petitioner also alleges that second respondent in collusion with other respondents filed Form No.2 on 26.11.1998 before RoC showing allotment of shares amounting to Rs.34,00,000/- (Rupees thirty four lakhs only). This is a fraud committed by respondents in order to evade payment of deposits fraudulently availed from shareholders, the allotment is bogus and shares were allotted in fictitious

names in favour of persons, who have not paid any consideration. Petitioner also alleged that respondents collected deposits from shareholders and members of public offering 18% interest per annum on investments but the funds collected were not reflected in the Balance Sheet as share application money. Deposits by way of cash transactions are fictitious, dubious and fraudulent and were held in dummy names. Subsequently, respondents converted these deposits into shares without obtaining consent of depositors in violation of Reserve Bank of India norms. Unilateral conversion of deposits into shares without informing depositors is a fraud. Other allegations made by petitioner is that second respondent purporting to relinquish post of Chairman and Managing Director (CMD) got appointed third respondent as CMD and got filed Form No.5 on 09.02.2000. Respondents 3 and 4 who are authorized to execute necessary security documents to create charge in favour of State Bank of India created second charge of Rs.60,00,000/- (Rupees sixty lakhs only) and Rs.10,00,000/- (Rupees ten lakhs only) at 18% interest per annum on all current assets of the company in favour of M/s.Laxmi Durga Binding Works and S.A.S.Vidyuth Nagar respectively, tenth and eleventh respondents. After fully paying the loan to State Bank of India, the charge created in favour of two creditors was modified as first charge. A mortgage deed was executed on 20.10.1999 in favour of M/s.Laxmi Durga Binding Works. It is also alleged that respondent did not circulate the Balance Sheet/Annual Reports. Annual General Meetings (AGMs) are not held and notice regarding them are not sent despite request by shareholders of the company. The twelfth respondent, first auditor of company was removed without approval of shareholders and thirteenth respondent was appointed as statutory auditor to ensure regularization of fictitious transactions. Second respondent diverted stocks of the company to his sole proprietary concerns, M/s.Laxmi Durga Binding Works, Chitralaya Laminations and Vivek Graphics. Respondents are also guilty of removing the movable items of the company and using sale proceeds for their personal benefit. The respondents committed acts of oppression and mismanagement and committed such acts continuously up to the date of filing the petition.

Counter-cum-preliminary objections were filed on behalf of respondents 1, 2, 4, 6, 10 and 11. Salient aspects of the same, in brief, are the following. Shareholding of petitioner is less than one-tenth of the total issued and paid up capital of company and therefore, petitioner does not satisfy the requirements of Sections 235(2) and 399(1)(a) of the Companies Act. Various acts alleged do not amount to acts of oppression and mismanagement. Petitioner and three others filed civil suits for recovery of value of allotted 53,800 shares. Petitioner, therefore, must clarify whether shares are held by them in company or they represent amount of pronotes for recovery of which suits were filed. The alleged consent, which is in the form of authorisation, given by other members for filing petition is a blanket

consent and based on the same, petition cannot be filed. It is not valid and it does not satisfy the requirements of Section 399(1) of the Companies Act. All the allegations are false, frivolous and vexatious. The authorised share capital of the company was Rs.25,00,000/- (Rupees twenty five lakhs only). It was enhanced to Rs.45,00,000/- (Rupees forty five lakhs only) on 21.12.1995 and subsequently to Rs.75,00,000/- (Rupees seventy lakhs only) on 23.03.1998. As authorised capital was less than the share application money received pending allotment it was shown under head 'unsecured loan' in the Balance Sheet of the company for 1996-1997. The allegation that the company accepted deposit from the public is false. The company never accepted any deposits from public. The petitioner and his family members were allotted shares on 25.03.1998 as per the application made by them, duly filing return of allotment in Form No.2 with RoC. As the shares were not allotted to petitioner and his family members, the question of refund of application money with interest does not arise. Mere delay in allotment of shares does not render allotment fraudulent or illegal. The allegation that he and his family members were not allotted is not true. Company allotted shares to him on 30.03.1996 and hence, the question of refund of money does not arise. The four persons whose affidavits are enclosed did not apply for any shares nor paid any consideration for allotment of shares. The company never accepted any deposits from the public nor circulated private and confidential letter inviting deposits from the public and shareholders. The company enhanced authorised capital to Rs.75,00,000/- (Rupees seventy five lakhs only) after notice of shareholders calling EGM on 23.03.1998. Necessary resolution was duly passed at the meeting and Form Nos.5 and 23 were filed with RoC. Further, allotment of shares after enhancement was made only to existing shareholders and shares were not allotted to persons who were not members of the company. This has also been mentioned in Annual Report. The company has been regularly sending notices to all the shareholders calling for AGM and also sending copies of Balance Sheet and Annual Reports along with notices. When petitioner requested for inspection of records of the company, he was allowed to inspect records. The allegation that twelfth respondent was removed as auditor is not correct. In the AGM held on 30.09.1997, twelfth respondent was not re-appointed on the grounds of misbehaviour. In his place, Members appointed thirteenth respondent and twelfth respondent did not raise objections for his non-appointment.

The allegation made by petitioner that he and his family members did not participate in AGM held on 24.09.1998 is false. Petitioner and others have themselves signed in the attendance register of AGM held on that day in which petitioner raised objections. Petitioner is the person who is creating trouble and preventing company from carrying business activities smoothly. He wrote letters to Banks for withdrawing guarantee given by him. He trespassed into company premises with anti-social elements to loot the

machinery. A complaint was given by first respondent company to Commissioner of Police. Petitioner approached the CLB with unclean hands, and he is main reason for stunted growth of the company. Petitioner even attacked second respondent and a complaint was lodged with Station House Officer on 03.02.2000.

On 15.10.1998, due to floods to Krishna river, the machinery and stocks of the company were damaged resulting in huge loss. The company raised claim with insurer. So as to prevent it from doing so, petitioner wrote frivolous letters with the help of twelfth respondent. In spite of the same, company was able to recover insurance claim. The company has been borrowing funds in accordance with the authority given by shareholders in EGM on 30.03.1996 and funds have been utilised for the purpose for which it has borrowed. The allegation that stocks of company were diverted to other firms is denied. The transactions between the company and other firms were done with approval of Board of Directors. Petitioner has given such a complaint, but, after thorough inspection it was found that there was no fault in stock transfers and settled insurance claim. There are no complaints from shareholders at any point of time. The company never did anything to defy shareholders or public nor diverted stocks for first respondent company to run sole proprietory concern of second respondent. Petitioner with an ulterior motive, in conspiracy with other members, is resorting to prevent company from achieving growth and development. The company petition is therefore liable to be dismissed.

Before the CLB, petitioner alleged eight acts of oppression and mismanagement. CLB summarised these as follows.

a) Illegal increase of the authorised share capital at the extra-ordinary general meeting allegedly convened on 23.03.1998 from Rs.45,00,000/- to Rs.75,00,000/-;
b) illegal allotment of shares by manipulation of records of the company and fraudulent filing of forms with Registrar of Companies;
c) delay in delivery of the share certificates in favour of the petitioner group;
d) illegal mobilisation of huge deposits from members of the public and unilateral conversion of such deposits into shares;
e) siphoning off the company's funds by illegal sale of the movable assets and diversion fo the stocks and utilisation of the sale proceeds and resources of the company for the benefit of the respondents and their proprietary concerns;
f) encumbering the assets of the company by creating charge in favour of the respondents 10 & 11, closely held by the 2nd secondrespondent;
g) non-sending of notices either for the general or annual general meetings and non-sending of balance sheets and annual reports of the company; and
h) illegal removal of the 12th respondent and the appointment of 13th respondent as the statutory auditor of the company without approval of the shareholders of the company.

Learned CLB, however, considered these under five points, namely, (1) Illegal increase of the authorised capital, allotment of impugned shares and delay in delivery of share certificates to petitioner group; (2) Siphoning off the company's funds by illegal sale of the movable assets, diversion of the stocks and encumbering the assets of the company; (3) Non-sending of notices for the general or annual general meetings of the company and non-sending of Balance Sheets and Annual Reports of the company; (4) Illegal mobilisation of huge deposits from members of the public and unilaterally converting such deposits into shares; and (5) Illegal removal of twelfth respondent and the appointment of thirteenth respondent as statutory auditor of the company without approval of the shareholders of the company.

Insofar as first point is concerned, learned CLB came to the conclusion that there is no evidence of service of notice of EGM on 23.03.1998 on petitioner group but the increase of authorised share capital was in the interest of the company and mere irregularity or illegality does not amount to oppression and mismanagement. CLB held that petitioner did not allege any prejudice on account of delay in delivery of share certificates especially when his grievance is redressed before filing company petition. So as to obtain correct position with regard to liabilities and charges of the company, CLB appointed Chartered Accountants (CAs) who submitted report. Based on the same, it came to conclusion that there are number of statutory violations and irregularities which are procedural in nature but not germane to the dispute before the CLB. On the third point as to whether notices for AGM and EGM were served, CLB came to the conclusion that petitioner attended AGM on 24.09.1998 pursuant to notice, dated 27.08.1998. On the question of illegal mobilisation of deposits, CLB did not believe the alleged circular issued by the company inviting deposits, that there is no material to prove that company converted deposits into shares without consent of depositors and that even if there is violation of Companies (Acceptance of Deposits) Rules, 1975, statutory authority can take suitable action against the company. On the question of appointment of thirteenth respondent as an auditor in place of twelfth respondent, having regard to inherent right of members to appoint their auditors and also the disciplinary proceedings pending before the Institute of Chartered Accountants of India against twelfth respondent, CLB came to the conclusion that most of the allegations made by twelfth respondent are hearsay and they were not proved. After recording these conclusions, CLB dismissed the petition.

In this appeal, learned counsel for petitioner/appellant submits that the company increased the authorised share capital from Rs.45,00,000/- (Rupees forty five lakhs only) to Rs.75,00,000/- (Rupees seventy five lakhs) fraudulently in the back of petitioner and that notice of EGM held on

23.03.1998 was not served on petitioner, and therefore, CLB ought to have set aside the same. According to learned counsel, irregularities and illegalities committed by the company in conducting EGM in increasing authorised capital and in allotting the same amount to acts of oppression and mismanagement warranting appropriate order under Sections 397, 398 read with Section 402 of the Companies Act. He would urge that the shares were allotted in 1996, share certificates were issued in 1998, and this deprived shareholders the right to attend the meetings and elect Directors to safeguard their interests. When there was a finding recorded by CLB that notices of AGM were not served, petition ought to have been allowed. Enhancement of share capital and delayed issue of share certificates to petitioner in December, 1998 and to other shareholders in January, 1999 is blatently illegal and CLB came to the wrong conclusion that belated submission of Returns would only attract penalty against the company. CLB ought to have held that the diversion of company stocks to run the proprietory concern of second respondent is contrary to interests of petitioner and other shareholders. He nextly contends that though M/s.Brahmaiah and Company, Chartered Accountants appointed by CLB pointed out grave procedural defaults and accepts commissions and omissions, CLB failed to see that these would amount to acts of oppression and mismanagement. Learned counsel relied on **Dale & Carrington Investment (Private) Limited v P.K.Prathapan**[1], **V.S.Krishnan v Westfort Hi-Tech Hospital Limited**[2] and **D.Ramkishore v Vijayawada Share Brokers Limited**[3].

Learned counsel for first respondent and learned counsel for second respondent opposed the appeal. Their arguments are as follows. An appeal under Section 10F of the Companies Act, in the facts and circumstances of the case, would not lie as the petitioner failed to point out any question of law arising out of impugned order of CLB. They rely on recent Judgment of this Court in **D.Ramkishore** (supra). They also submit that increase of authorised share capital and allotment of shares for the benefit of the company does not amount to an act of oppression and mismanagement especially when the increased capital was allotted only to the members and not to outsiders. Thirdly, they would urge that the alleged procedural irregularities pointed out by petitioner or the auditors appointed by CLB do not come within purview of acts of oppression and mismanagement and therefore, no interference is called for.

In an appeal under Section 10(5) of the Companies Act against an order of CLB in a company petition, petitioner must show that “a question of law arises out of impugned order” and secondly there are proven acts of oppression and mismanagement on the part of respondents towards minority shareholders and therefore, their grievance need to be redressed in appropriate manner. These are the issues, which require consideration.

Section 10F of the Companies Act provides for an appeal to any person aggrieved by decision or order of CLB only on a question of law. Such question of law is not a general question of law which has to be pointed out. The petitioner necessarily points out that "the question of law arises out of the order of CLB" impugned in the appeal. When a question of law is said to arise out of an impugned order? An erroneous findings of fact or an erroneous inference drawn by CLB from the facts or refusal to exercise discretion vested in it or by themselves do not warrant exercise of appellate jurisdiction.

In **Dale & Carrington Investment (Private) Limited** (supra), Supreme Court considered scope of power of High Court in Appeal under Section 10F of the Companies Act, and laid down that, *if a finding of fact is perverse and is based on no evidence, it can be set aside in appeal even though the appeal is permissible only on the question of law. The perversity of the finding itself becomes a question of law.*

In **V.S.Krishnan** (supra), speaking for the Bench his Lordship Justice P.Sathasivam reiterated the scope of Section 10F of the Companies Act, thus:

> It is clear that Section 10-F permits an appeal to the High Court from an order of the Company Law Board only on a question of law i.e. the Company Law Board is the final authority on facts unless such findings are perverse, based on no evidence or are otherwise arbitrary. Therefore, the jurisdiction of the appellate court under Section 10-F is restricted to the question as to whether on the facts as noticed by the Company Law Board and as placed before it, an inference could reasonably be arrived at that such conduct was against probity and good conduct or was *mala fide* or for a collateral purpose or was burdensome, harsh or wrongful. The only other basis on which the appellate court would interfere under Section 10-F was if such conclusion was (*a*) against law or (*b*) arose from consideration of irrelevant material or (*c*) omission to construe (*sic* consider) relevant materials.

In a recent Judgment in **D.Ramkishore** (supra), Hon'ble Sri Justice Ramesh Ranganathan considered this aspect of the matter. Referring to **Sree Meenakshi Mills Limited v CIT**[4], **Deity Pattabhiramaswamy v S.Hanymayya**[5] and **Mattulal v Radhe Lal**[6], His Lordship explained the scope of appellate jurisdiction of this Court as follows.

> There is no jurisdiction to entertain an appeal on grounds of erroneous findings of fact, however gross the error may seem to be, for if the question to be decided is one of fact it does not involve an issue of law. … It is only an error of law which can be corrected by the High Court in exercise of its jurisdiction under Section 10F of the Companies ACT. If the finding recorded by the High Court can certainly examine its correctness, but if it is unreasonable and perverse, but where there is evidence to consider, the decision of the Company Law Board is final even though the High Court might

> not, on the materials, have come to the same conclusion if it had the power to substitute its own judgment. … In between the domains occupied respectively by questions of fact and of law, there is a large area in which both these questions run into each other, forming enclaves within each other. The questions that arise for determination in that area are known as mixed questions of law and fact. These questions involve first the ascertainment of facts on the evidence adduced and then a determination of the rights of the parties on an application of the appropriate principles of law to the facts ascertained. The ultimate finding on the issue must, therefore, be an inference to be drawn from the facts found, on the application of the proper principles of law, and in such cases an inference from facts is a question of law. In this respect, mixed questions of law and fact differ from pure questions of fact in which the final determination, equally with the finding or ascertainment of basic facts, does not involve the application of any principle of law. The proposition that an inference from facts is one of law will be correct in its application to mixed questions of law and fact but not to pure questions of fact. When the finding is one of fact, the fact that it is itself in inference from other basic facts will not alter its character as one of fact.

Thus, from the three authorities referred to hereinabove, it may be taken as well settled that an appeal under Section 10F would lie only when an error of law is pointed out. If the question involved is one of mixed question of fact and law, an appeal would lie only when it is shown that CLB erroneously drawn an inference which is not possible. If it is a mere question of fact, even if an inference is drawn by CLB, and such inference is erroneous, appeal would not lie because the High Court sitting in appeal under Section 10F of the Companies Act cannot substitute its opinion to that of the CLB on a question of fact or inference drawn from the facts.

Learned counsel for petitioner strenuously contends that the auditors appointed by CLB found that there were number of statutory violations and irregularities which themselves amount to acts of oppression and mismanagement and therefore, CLB ought to have allowed the application. He also points out that though the findings were recorded by CLB in favour of petitioner with regard to non-service of notice of EGM for enhancement of share capital, respondents were let off which itself is erroneous in law. Before considering these aspects, it is necessary again to refer to **V.S.Krishnan** (supra).

After referring to **Needle Industries (India) Limited v Needle Industries Newey (India) Holding Limited**[7], **M.s.Madhusoodhanan v Kerala Kaumudi (Private) Limited**[8] **Dale & Carrington Investment (Private) Limited** (supra), **Sangramsinh P.Gaekwad v Shantadevi P.Gaekwad**[9] and **Kamal Kumar Dutta v Ruby General Hospital Limited**[10], Supreme Court summarised the points from which oppression would be made out. These are:

(a) Where the conduct is harsh, burdensome and wrong.

(b) Where the conduct is *mala fide* and is for a collateral purpose where although the ultimate objective may be in the interest of the company, the immediate purpose would result in an advantage for some shareholders vis-à-vis the others.

(c) The action is against probity and good conduct.

(d) The oppressive act complained of may be *fully permissible under law but may yet be oppressive* and, therefore, the test as to whether an action is oppressive or not is not based on whether it is legally permissible or not since even if legally permissible, if the action is otherwise against probity, good conduct or is burdensome, harsh or wrong or is *mala fide* or for a collateral purpose, it would amount to oppression under Sections 397 and 398.

(e) Once conduct is found to be oppressive under Sections 397 and 398, the discretionary power given to the Company Law Board under Section 402 is set right, remedy or put an end to such oppression is very wide.

(f) As to what are facts which would give rise to or constitute oppression is *basically a question of fact* and, therefore, whether an act is oppressive or not is fundamentally/ basically a question of fact.

Reverting back to the submissions of learned counsel, this Court has perused the report of CAs, who were appointed by CLB to verify and submit report on certain transactions. The terms of reference to the auditors are (a) to furnish a list of liabilities of the Company as on 30.06.2002; (b) printing machinery sold by the Company to M/s.Moon Books Private Limited; (c) the charges created on the assets of the Company for the facilities said to have been advanced by M/s.Sri Laxmi Durga Binding Works and others belonging to respondent group. In furtherance thereof, the CAs submitted its report after verifying the Books of Accounts, records and other documents made available to them by second respondent and accountant. In their report, CAs pointed out that the transactions with M/s.Laxmi Durga Binding Works are not entered in the register maintained under Section 301 of the Companies Act, that the company advanced certain amounts to M/s.Laxmi Durga Binding Works in contravention of Section 295 of the Companies Act, a part of which was repaid and the Company credited Rs.3,75,963/- to the firm towards binding charges for note books and that the company passed necessary resolution under Section 297 of the Companies Act on 05.09.1995. Similar transactions were pointed out for other financial years. Insofar as sale of printing machinery to M/s.Moon Books Private Limited, CAs observed that depreciation was not provided in the accounts on the fixed assets for the years from 1999-2000 to 2001-2002, that there was delay in filing Form No.23 with RoC, that no advertisement was issued inviting tenders and that sale proceeds of the machinery sold were not reflected in the Schedules of Depreciation annexed to return of income for the year ending 31.03.2002 though the same was reflected in the

Schedules of fixed assets forming part of Accounts for the year ending 31.03.2002. CAs also verified charges created on assets and furnished the list but did not comment anything on these charges created by the Company. Dealing with this aspect, CLB observed that the report disclosed quite a number of statutory violations and irregularities which are procedural in nature and are not, however, germane for the dispute before the CLB and that it is for the Government authority to take appropriate action for such violations as may be deemed fit. While doing so, CLB noticed the salient features of CA's Report and came to the conclusion that though there are procedural irregularities, they would not amount to acts of oppression and mismanagement.

The finding of CLB cannot be considered as an error of law. The question before it was whether inadequate or improper procedure adopted to sell assets of the company was an act of oppression and mismanagement. Admittedly, petitioner did not give any complaint to any regulatory authority about non-compliance with the provisions of the Companies Act while selling movable assets of the company. It is also not the case of the petitioner that the amounts realised by sale of machinery are not reflected in the Books of Accounts. Even if such contention is made, the same cannot be accepted. In their report, CAs appointed by CLB, did not arrive at any such finding. On the contrary, the observation of the CAs was that the sale proceeds of the machinery sold was not reflected in the Schedule of Depreciation annexed to the Return of Income Tax though the same was reflected in Schedule of Fixed Assets forming part of Accounts for the year ending 31.03.2002. The consideration of pre and post sale incidents would show that the machinery was damaged in the floods and the company submitted a consolidated claim to the United India Insurance Company Limited and received the claim. After receiving the claim, the machinery was sold and that way there appears to be no substantial loss to the company.

Insofar as non-sending of notices for general or AGM of the Company, the findings of CLB are as follows.

> The petitioner has not substantiated his grievances on account of non-receipt of notices for the general and annual general meeting of the company or non-sending of balance sheets and annual reports at any prior point of time. On the other hand, copies of the notice dated 01.09.1998 for the annual general meeting held on 24.09.1998 and the special notice for the appointment of 13th respondent as the statutory auditor are produced by the 12th respondent. It is further observed that the petitioner had attended the annual general meeting held on 24.09.1998 pursuant to notice dated 27.08.1998, wherein however, it is found that he questioned validity of said meeting on several accountants. The grievances which are not acceptable in entirety are being appropriately remedied.

The finding recorded by CLB as above is reasonable and rationale. If there are one or two instances where notices sent by the Company are not received by petitioner or the likes and/or by inadvertence notice was not dispatched by the Company, the same cannot be an act of oppression and mismanagement unless *mala fide* action on the part of the Company and its officials is pleaded and proved. No such effort was made by petitioner. Insofar as removal of twelfth respondent and appointment of thirteenth respondent is concerned, learned counsel for petitioner did not point out any error in the finding recorded. Even otherwise there is no denial that twelfth respondent is facing disciplinary action by Institute of Chartered Accountants of India and that itself could be the reason for the removal as statutory auditor of the company.

After giving anxious consideration and perusing the material on record, this Court is convinced that the impugned order of CLB does not warrant any interference. The Company Appeal is therefore dismissed. No costs.

(V.V.S.RAO,J)

06.08.2009
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[1] (2005) 1 SCC 212
[2] (2008) 3 SCC 363 : (2008) 142 Comp Cas 235
[3] (2008) 144 Comp Cas 326 (AP)
[4] (1957) 31 ITR 28 (SC)
[5] AIR 1959 SC 57
[6] AIR 1974 SC 1596
[7] (1981) 3 SCC 333
[8] (2004) 9 SCC 204
[9] (2005) 11 SCC 314
[10] (2006) 7 SCC 613